

DATE: July 25, 2011

MEMO CODE: CACFP 24-2011

SUBJECT: Automatic Revocation of Tax Exempt Status

TO: Child Nutrition Programs

The Internal Revenue Service (IRS) has recently changed its filing requirements for some tax-exempt organizations. Failure to comply with the requirements may result in the revocation of an organization's tax-exempt status by the IRS. The Richard B. Russell National School Lunch Act requires sponsors of family day care homes and unaffiliated centers to be public or private non-profit organizations [42 USC §1766(a)(2)]. Further, the Act defines a private non-profit organization as one that has tax-exempt status under the Internal Revenue Code [42 USC §1766(d)(1)(B)].

As a result, the Child and Adult Care Food Program (CACFP) sponsors that have had their tax-exempt status automatically revoked by the IRS are not eligible for participation in CACFP. This memorandum is intended to provide guidance to CACFP State agencies with institutions that have had their non-profit tax-exempt status revoked. Guidance for the Summer Food Service Program and the School Meal Programs are being issued separately.

According to the IRS, most tax-exempt organizations are required to file an annual return or notice with the IRS. Exceptions to this requirement include governmental and many faith-based organizations. Pursuant to authority in Section 6033(j) of the Internal Revenue Code of 1986, the IRS must automatically revoke the tax exemption of any private nonprofit organization that fails to satisfy its filing requirement for three consecutive years. The IRS has in place an application process in which organizations may seek reinstatement of tax-exempt status after automatic revocation. Such reinstatements are generally effective on the date of the IRS determination, but retroactive reinstatement may be requested. Additional information about automatic revocation of tax-exempt status may be found at:

<http://www.irs.gov/charities/article/0,,id=239696,00.html>.

Recently, the IRS initiated this automatic tax exemption revocation and it is possible that some CACFP institutions are affected. Tax exemption is a condition of eligibility for most CACFP institutions and required for participation. Therefore, revocation of tax exemption is considered a serious deficiency requiring corrective action or termination, because it affects the institution's ability to administer the Program in accordance with Program requirements [7 CFR §226.6(c)(3)(ii)(U)]. If an approved CACFP institution has had its exemption revoked, the State agency must follow the termination procedures outlined in 7 CFR §226.6(c)(3), which includes providing notice of serious deficiency and an opportunity for corrective action. A State agency must require corrective action for this serious deficiency within 30 business days of receipt of the notice.

The only appropriate corrective action would be an institution's submission of documentation from the IRS indicating that (a) the institution sponsor or the part of the organization under which the institution is operating continues to be tax exempt under Section 501(a) of the Internal Revenue Code of 1986 or (b) the institution has submitted an application to the IRS for reinstatement of tax-exempt status. (Please note that fees associated with applying for tax-exempt status are not allowable CACFP costs.). If institutions are unable to provide such documentation, the State agency must move to terminate.

Institutions applying for reinstatement must inform the State agency immediately upon receipt of an IRS determination of tax-exempt status. The State agency must move to terminate such institutions if tax-exempt status has not been reinstated within 120 days of their receipt of the original serious deficiency notice.

Additionally, independent child care centers classified as nonprofit that appear on the IRS Automatic Revocation list are subject to the serious deficiency process. Although tax-exempt status is not required for independent centers, if they are not tax exempt they must meet the additional requirements to qualify as a for-profit center [42 USC §1766(a)(2)(B)]. If they fail to meet the additional requirements, the State agency must initiate the serious deficiency process outlined in 7 CFR §226.6(c)(3) and move to terminate if appropriate corrective action is not taken in the required timeframe.

The Notice of Proposed Termination action based on revocation of tax-exempt status is subject to administrative review under the procedures described in 7 CFR §226.6(k). State agencies are required to continue to pay valid claims for reimbursement until the State agency terminates the institution's agreement, including the period of any administrative review [7 CFR §226.6(c)(3)(F)]. Once the administrative review process has been completed, terminated institutions must be placed on the National Disqualified List (NDL). Institutions terminated based on revocation of tax-exempt status may request removal from the NDL and reapply to participate in CACFP when tax-exempt status is reinstated. Additionally, terminated

independent centers are eligible to request removal from the NDL and reapply as for-profit centers if they meet those additional requirements in the future.

By August 5, 2011, all CACFP State agencies must review the IRS Automatic Revocation of Exemption List (List) and determine whether any of the State agencies' approved CACFP institutions are listed. The List, which is organized by State, may be found at: <http://www.irs.gov/charities/article/0,,id=240099,00.html>. The related serious deficiency notices must be sent to the affected institutions by August 31, 2011.

Additionally, State agencies must check the List for any institution whose application to participate in CACFP is pending. Applicant sponsors appearing on the IRS list may not be approved unless they can provide IRS documentation indicating that the organization or the part of the organization under which the institution is operating continues to be tax-exempt under the Internal Revenue Code. Applicant centers appearing on the list may be approved as for-profit centers if they can demonstrate eligibility. Going forward, State agencies must check the List before approving new institution applications or approving renewing institution participation and are encouraged to check the List periodically throughout the year.